



A new generation of industrial policies for LDCs

LDC5 side event co-organized by UNCTAD and UNIDO

8 March 2023, 12:15 – 13:45 (Doha time), Exhibition Hall 2A

Concept Note

Introduction

The current framework of domestic policies for industrial development and structural transformation has thus far not helped most LDCs overcome the major development challenges they face. Many still remain with a meagre industrial output, low levels of value addition to local products, a minor share of manufacturing in the economy, and marginal levels of integration in global trade. In 36 out of the present 46 LDCs manufacturing accounts for less than 12% of GDP. For 35 LDCs, manufactures account for less than 30% of their exports, while on the other hand 85% of LDCs continue to be commodity-dependent.¹

It is therefore timely – especially considering learnings from the COVID pandemic – to design and implement a new generation of industrial policies for LDCs that are more effective and adjusted to present conditions of the world economy. It should lead to structural transformation and accelerate the path of LDCs towards graduation with momentum.

Trends in industrial production and trade

Evidence seems to emerge that industrial production in LDCs has been less affected by the COVID crisis than the world average (UNIDO 2021). However, this may only be relatively good news given the low levels of industrialization and integration in LDCs' manufacturing trade. Meanwhile, doubts exist whether smaller manufacturing firms, which account for the largest

¹ According to UNCTAD's *The State of Commodity Dependence 2021*, a country is commodity-dependent if more than 60% of its merchandise exports consists of commodities.

share of the manufacturing sector in LDCs, are also on the road to recovery. Larger firms and firms in other developing countries have started to build back more quickly, leaving manufacturing firms in LDCs behind, particularly in the small and informal business sector.

LDCs' trade in manufactured goods has been more severely affected by the pandemic than industrial production and shows a continuous downward trend already before COVID. With reduced trade and stable industrial output, an opportunity seems to emerge for LDCs to compensate the loss of trade with local and less distant production and consumption.

The need for industrial policy action

Around the globe we witness a rediscovery of the idea that development is achieved through the transformation² of a predominantly rural and highly informal economy into a 'modern' economy with a thriving industrial sector at its core (UNIDO 2020). Industrialization is now seen as one of the main engines of sustained economic growth, especially in the early stages of development.

Indeed, few countries have been economically successful without industrializing (UNIDO 2009), for various reasons: First, productivity tends to be higher, on average, in manufacturing than in agriculture and in the services sector thanks in part to higher levels of capital per workers. Second, the manufacturing sector is the source of most innovations and advances in technology. Third, the manufacturing feeds into the growth process beyond the sector itself as other parts of the economy make use of the newly developed technologies. Finally, industrialization is an engine for economic in the context of globalization, as it provides an almost infinite potential for growth.

Hence, boosting industrial production capacities represents a promising strategy for LDCs to develop. Indeed, industrial development is crucial for boosting LDCs' ability to respond to and recover from crises such as COVID-19 and to make progress towards sustainable development and graduation with momentum. However, industrialization lags behind in LDCs. For example, from 2000 to 2021, the share of LDCs in world population grew from 10,7 to 13,7 percent, while their share in the world's manufacturing value added remained at 1%. So it appears that the policies of the past did not have the development effects intended, when it comes to industrial development.

This means that a new policy mix needs to be considered to foster industrial development and structural transformation in LDCs. An appropriate policy framework and institutions are indispensable for initiating a sustained industrial growth process and successful structural transformation.

² Structural transformation is the phenomenon whereby an economy's resources (human, natural, and produced capital) are shifted from the sectors and activities where they yield little economic benefits to those where the payoffs are the highest—and this occurs mostly through industrialization. Prosperity is achieved in any country only when a country's resources are transferred from subsistence and informal activities to high-productivity activities.

Elements of a new generation of industrial policies

To future-proof industry in LDCs, governments need to craft policies that promote the production of industrial goods in a slightly different way than in the past. What should the main features of such reshaped industrial policies in LDCs? In the short term, policy measures may need to offset increased risk aversion and prevent flight-to-liquidity, which could exacerbate financial stress, particularly in emerging and developing markets, thus curtailing access to the resources needed to manage the anticipated consequences of COVID-19 for the economy. In the medium to long run, policies for industrial development in LDCs must also take account of strategic considerations.

- Policies need to foster industrial development **by considering economic benefits at the firm level** and at the social and environmental costs and benefits, including the creation of labour, income and poverty alleviation. Policies should consider the value that industrial production generates across the segments of the value chain in the country.
- Policies could follow a path of **national / regional development and increased risk aversion and** as regards dependency on supplies as well as on markets and products for export, leading to measures of diversification, import substitution and sourcing from and marketing to less distant places.
- Policies may aim to secure **supply of the most important (strategic) products** consumed in the country given possible disruptions in global value chains; this includes firms investing in new business processes and technological innovation.
- Policies may make **more strategic use of existing local resources**. By contrast, using land resources for the production of food to be exported and labour resources for the assembly of products for distant markets needs to be subject to renewed cost-benefit and risk analyses.
- Policies should **foster the spillover of knowledge and technology** from leading industrial sectors and potentially from GVC suppliers to other priority sectors.
- Policies should target the **creation of knowledge and skills** required to strengthen and extend local production and value addition capacities.
- Policies should promote **technology learning and technology transfer** to extend the manufacturing sector's productive capacity.
- Policies should **foster innovation in priority sectors**, including co-funding of R&D. This includes increasing spending on science, technology and innovation capabilities to enhance productivity and competitiveness.
- Policies should **focus on the entire portfolio of industrial firms** from small to large and elaborate enterprise development and upgrading strategies that allow for structural change with continued support for those that can grow, and cushioning measures for those that drop out.
- Policies should **consider the fiscal limits** of countries and the development community and focus on industries and subsectors where most value for society can be created.
- Policies should support consumer behaviour analysis and **identify low-risk markets**, allowing firms to identify emerging sales options quickly.

Public-private action

Overall, developing productive capacities in manufacturing industries allows the world's poorest countries to foster structural economic transformation, which in turn will help reduce poverty and accelerate progress towards the Sustainable Development Goals (SDGs). In this, a balance needs to be struck between saving existing businesses in the industry—including SMEs and in the informal sector—and building forward industries to a level that is more resistant to external shocks, such as pandemics and volatile markets for supplies and industrial end-products, and provide a basis for inclusive and sustainable industrial development in LDCs.

Industrial policies for LDCs cannot be „one size-fits-all“ but would need to consider resource endowment, geopolitical positioning and level of development of each country. The design of such policies would not go without improved capacity in the countries. And overall, without improved state capacity—the ability to accomplish policy goals—LDCs will remain on the margins of the global economy.

Efforts in crafting a new-generation industrial policies in LDCs would also benefit from coordinated national and international policies under a common framework for the inclusive transformation and diversification of LDCs' industrial production and export structures (UN, 2021).

Purpose of the side-event

The purpose of the side event is to discuss the new generation of industrial policy measures and develop recommendations how LDCs, via such measures, can spur sustainable industrial development, innovation, structural transformation and build resilience.

Expected outcomes

The expected outcome is recommendations for an industrial policy agenda for LDCs that fosters structural transformation in LDCs in the post-COVID era and helps these countries advance towards graduation with momentum. Concrete outputs include:

- Increased awareness of policymakers of LDCs and their development partners of the crucial contribution that industrial policies make to the implementation of the Doha Programme of Action;
- Formulation of new ideas and proposals for industrial policies adapted to the realities and needs of LDCs in the 21st century and to the evolving global realities;
- Support to LDCs' processes of structural transformation to achieve graduation with momentum.

The main contribution of the event to LDC5 is expected to be threefold:

1. Contribution to the establishment of priorities for the design and implementation of industrial policies by LDCs in the 2020s;
2. Understanding of how LDCs can best position themselves vis-à-vis the ongoing restructuring of global and regional value chains;
3. Delineation of policies for the structural transformation of LDC economies in the pursuit of SDGs and Goals of the Doha Programme of Action.